

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

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Court of Appeals of the District of Columbia

APRIL TERM, 1933

No. 5941

363

RUSSELL-MILLER MILLING COMPANY,
APPELLANT,

J. Helsering

vs.

~~DAVID BURNET~~, COMMISSIONER OF INTERNAL
REVENUE.

APPEAL FROM THE BOARD OF TAX APPEALS.

FILED APRIL 20, 1933.

PRINTED MAY 17, 1933.

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Court of Appeals of the District of Columbia

No. 5941.

RUSSELL-MILLER MILLING COMPANY, Appellant,
vs.
DAVID BURNET, Commissioner of Internal Revenue.

1 Docket No. 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

Appearances:

For Taxpayer: Ben Jenkins, Esq., Earle Wallick, Esq.
For Respondent: E. L. Corbin, Esq.

Docket Entries.

1931.

Sept. 22. Petition received and filed. Taxpayer notified.
(Fee paid.)
Sept. 22. Copy of petition served on General Counsel.
Oct. 7. Answer filed by General Counsel.
Oct. 14. Copy of answer served on taxpayer—General
Calendar.

1932.

July 8. Hearing set Sept. 26, 1932.
Aug. 5. Application for order to take depositions filed by
taxpayer. Withdrawn 8/18/25—B. Jenkins.
Aug. 12. Motion for extension of 5 days to file objections
filed by General Counsel. 8/13/32 granted.
Aug. 18. Stipulation of facts filed.
Aug. 18. Notice of appearance of Earle Wallick as counsel
filed.
Sept. 26. Hearing had before Mr. Smith on merits. Sub-
mitted on record. Briefs due in 30 days.

1932.

- Oct. 6. Transcript of hearing of Sept. 26, 1932, filed.
Oct. 21. Request for findings of fact and brief filed by taxpayer.
Oct. 25. Brief filed by General Counsel.
Dec. 21. Opinion rendered—Charles P. Smith, Division 5.
Judgment will be entered for the respondent.
Dec. 22. Decision entered—Charles P. Smith, Division 5.

1933.

- Mar. 14. Stipulation to have case reviewed by Court of Appeals of District of Columbia filed.
Mar. 14. Petition for review to Court of Appeals of District of Columbia with assignments of error filed by taxpayer.
Mar. 14. Proof of service of petition filed.
Mar. 14. Præcipe with proof of service thereon filed.

2 Filed Sept. 22, 1931.

United States Board of Tax Appeals.

Docket No. 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition.

The above-named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:D-5:EEC-60D dated August 20, 1931, and as a basis of its proceeding alleges as follows:

1. The petitioner is a North Dakota corporation, with its principal office at 424 Security Building, Minneapolis, Minnesota.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on August 20, 1931.

3. The taxes in controversy are income taxes for the fiscal year ended August 31, 1929, and for \$582.60.

4. The determination of tax set forth in the said notice of deficiency is based, in part, upon the following error:

(a) The failure of the respondent to allow as a credit against the tax due to the United States, British taxes paid in the amount of \$582.60.

3 5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) In its fiscal year ended August 31, 1929, and on or about November 27, 1928, the petitioner paid British Income Tax in the amount of \$582.60, based upon a compromise settlement by it accepted on October 30, 1928, of an assessment then made of £100 equalling £20 in tax for the year 1925-1926, and of £500 equalling £100 in tax for the year 1926-1927.

(b) The respondent has refused to allow this payment of a tax imposed by a foreign country as a credit against the tax imposed upon the plaintiff's income by the Revenue Act of 1928.

Wherefore the petitioner prays that this Board may hear the proceeding and determine that the said amount of \$582.60 of British Income Tax constitutes and is a proper credit against petitioner's tax liability for its fiscal year 1929 as imposed by the Revenue Act of 1928.

BEN JENKINS,
Counsel for Petitioner,
1001 Fifteenth St. N. W.,
Washington, D. C.

4 STATE OF MINNESOTA,
 County of Hennepin, ss:

W. C. Helm, being duly sworn, says that he is the Vice-President of the petitioner corporation, and duly authorized to verify the foregoing petition; that he has read the said petition, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

W. C. HELM.

Sworn to and subscribed before me this 16th day of September, A. D. 1931.

[Notarial Seal, Hennepin Co., Minn.]

H. A. GOSLIN,
Notary Public.

H. A. Goslin, Notary Public, Hennepin County, Minn.
My commission expires Jan. 22nd, 1937.

EXHIBIT "A".

Treasury Department, Washington.

August 20, 1931.

Russell-Miller Milling Company,
424 Security Building,
Minneapolis, Minnesota.

SIRS:

You are advised that the determination of your tax liability and that of your affiliated companies for the fiscal year ended August 31, 1929, discloses a deficiency of \$5,110.65 as shown in the statement which is attached to and made a part of this letter.

In accordance with section 272 of the Revenue Act of 1928 and Article 16 of Regulations 75 relating to consolidated returns of affiliated corporations prescribed under section 141(b) of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days, (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability and that of your affiliated companies.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner,

(Sgd.)

By J. C. WILMER,
Deputy Commissioner.

Enclosures: Statement, Form 882, Form 870-c-29, Schedules 1 to 12, inclusive.

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Statement.

IT:AR:D-5. EEC-60D.

Returns Examined.

	Form.	Fiscal year ended.
Parent Company:		
Russell-Miller Milling Company, 424 Security Building, Minneapolis, Minnesota.....	1120A	August 31, 1929
Subsidiary Companies:		
Occident Elevator Company, 447 Security Building, Minneapolis, Minnesota.....	1122	August 31, 1929
Electric Steel Elevator Company, 445 Security Building, Minneapolis, Minnesota.....	1122	August 31, 1929
American Elevator and Warehouse Company, Incorporated, Foot of Childs Street, Buffalo, New York.....	1122	August 31, 1929
Occident Terminal Company, 310 Board of Trade Building, Duluth, Minnesota.....	1122	August 31, 1929

Tax Liability.

Tax liability of Russell-Miller Milling Company and each subsidiary company above named as provided for in article 15(a) of Regulations 75 prescribed under section 141(b) of the Revenue Act of 1928.

Year.	Tax liability.	Tax assessed.	Deficiency.
Fiscal — ended August 31, 1929...	\$168,245.60	\$172,731.12	
Less amount abated.....		9,596.17	
		<u>\$163,134.95</u>	\$5,110.65

7 In accordance with article 16(a) of Regulations 75, the deficiency will be assessed severally against each corporation named above.

The adjustments resulting in the above deficiency are fully explained in the attached schedules 1 to 12, inclusive.

Very careful consideration has been given to your protest against the disallowance of \$582.60, representing British taxes for 1925, 1926 and 1927, which were paid in the year 1929, and claimed as a credit against taxes due the United States for the fiscal year 1929. You are advised that since your books of account and records are kept on the accrual basis, credit for foreign taxes must be taken on an accrual basis, and not in the year of payment. The adjustment is made in accordance with the provisions outlined in General Counsel Memorandum 5971, published in Internal Revenue Bulletin, Cumulative Bulletin VIII-1, page 182.

8 Russell-Miller Milling Company, Fiscal Year Ended August 31, 1929.

SCHEDULE 1.

Net Income.

Net income as disclosed by return.....	\$679,496.55
As corrected.....	711,363.36
Adjustment.....	<u>\$31,866.81</u>

2—5941a

Unallowable deductions and additional income:

(a) Donations charged to dues and subscription account.....	\$550.00	
(b) Excessive depreciation disallowed.....	26,268.86	
(c) Adjustment for real estate and personal property taxes.....	2,007.21	
(d) Loss from sale of Lakeville machinery....	3,040.74	
Total.....		\$31,866.81
Adjustment as above.....		\$31,866.81

SCHEDULE 2.

Explanation of Items Changed.

(a) Income has been increased by \$550.00, representing donations to Young Men's Christian Association.....	\$500.00
Minneapolis Church Federation.....	50.00
	<u>\$550.00</u>

The adjustment has been made in accordance with the provisions of article 262 of the Revenue Act of 1928.

(b) The amount of depreciation allowed on the various assets is shown as follows:

Office equipment.....	\$4,368.65
9 Brought Forward.....	\$4,368.65
Nonfireproof plants:	
Allowed in Agent's report.....	\$103,351.18
Allowed as a result of a conference in agent's office (\$2,641.00 at 5%).....	132.05
	<u>103,483.23</u>
Fireproof plants:	
Allowed in agent's report.....	\$68,075.01
Allowed as the result of a conference in agent's office (\$2,500.00 at 2 1/2%).....	62.50
	<u>68,137.51</u>
Total depreciation allowable.....	\$175,989.39
Depreciation deducted on return.....	202,258.25
	<u>\$26,268.86</u>

The details of the allowance for depreciation are given in the schedules submitted in the revenue agent's report, a copy of which has been furnished you.

(c) The adjustment for the proper accrual of real estate and personal property taxes is shown as follows:

1928 real estate and personal property tax paid during 1929 charged against accrued tax account.....	\$70,395.25
1928 real estate and personal property tax paid at Buffalo, New York, charged to profit and loss.....	19,689.78
1928 real estate tax paid at Joliet, charged to an asset account..	28.80
	<u>\$90,113.83</u>
1929 franchise and license tax, charged to profit and loss.....	12,120.80
	<u>\$102,234.63</u>
Total deducted in the return.....	100,227.42
Total deduction for taxes allowed (see schedules below).....	
Excessive deduction disallowed.....	\$2,007.21

10 The allowance of \$100,227.42 as the proper accrual of taxes is shown as follows:

Accrued 1929 real estate and personal property tax paid in 1930.	\$69,200.53
1929 tax paid at Joliet allowed as a current deduction.....	28.80
1929 real estate and personal property tax paid at Buffalo, New York.....	\$19,689.78
Less prepaid portion of tax.....	812.49
	<u>18,877.29</u>
Total real estate and personal property tax.....	\$88,106.62
1929 franchise and license tax allowed as a current deduction...	<u>12,120.80</u>
Total deduction for taxes allowable as shown above.....	\$100,227.42

(d) The adjustment for the loss from sale of Lakeville plant is shown by the following computation:

Cost of plant (1925).....	\$55,963.51
Less accrued depreciation at 5% for 3½ years.....	9,793.61
Depreciated cost.....	<u>\$46,169.90</u>
Add value of lot.....	3,000.00
	<u>\$49,169.90</u>
Proceeds received from sale.....	5,549.41
Loss.....	<u>\$43,620.49</u>
11 Brought Forward.....	\$43,620.49
Less proceeds from sale of fully depreciated assets credited to plant accounts.....	<u>4,715.19</u>
Deductible loss on sale of plant.....	\$38,905.30
Amount deducted on return.....	<u>41,946.04</u>
Excessive deduction disallowed.....	\$3,040.74

Occident Elevator Company.

SCHEDULE 3.

Net Income.

Net income as disclosed by return.....	\$299,082.83
As corrected.....	<u>305,831.61</u>
Adjustment.....	\$6,748.78
Unallowable deductions and additional Income:	
(a) Adjustment for real estate and personal property taxes.....	\$6,702.49
(b) Excessive depreciation.....	46.29
Total.....	<u>\$6,748.78</u>
Adjustment as above.....	<u>\$6,748.78</u>

SCHEDULE 4.

Explanation of Items Changed.

(a) The amount of \$6,702.49 has been disallowed, as an excessive deduction from income, for accrued real estate and personal property taxes. The adjustment is shown as follows:

12	Deduction taken on return.....	\$38,452.81
	1929 real estate and personal property taxes accruable in 1929.....	31,750.32
	Excessive deduction disallowed.....	<u>\$6,702.49</u>

(b) The adjustment for depreciation is shown as follows:

Depreciation deducted on return:

Plant.....	\$30,366.64	
Furniture and fixtures.....	727.94	
	<u> </u>	\$31,094.58

Depreciation allowable:

Plant.....	\$30,366.64	
Furniture and fixtures (see below).....	681.65	
	<u> </u>	31,048.29

Excessive depreciation disallowed.....	\$46.29
--	---------

The excessive depreciation was taken on office equipment, shown as follows:

Office equipment, \$7,279.46 at 10%.....	\$727.95
Fully depreciated assets in 1929, \$926.00 at 5%.....	(46.30)

Total allowance for depreciation on furniture and fixtures.	<u>\$681.65</u>
---	-----------------

Electric Steel Elevator Company.

SCHEDULE 5.

Net Income.

Net income as disclosed by return.....	\$163,964.75
As corrected.....	162,851.66
Adjustment.....	<u>\$1,113.09</u>

13	Nontaxable income and additional deductions:	
	(a) Adjustment for real estate and personal property tax...	\$1,113.09
	Adjustment as above.....	<u>\$1,113.09</u>

SCHEDULE 6.

Explanation of Items Changed.

(a) The adjustment for real estate and personal property taxes is shown as follows:

1929 real estate and personal property taxes accruable.....	\$16,362.73
Real estate and personal property taxes deducted on return....	15,249.64
Additional deduction allowed.....	<u>\$1,113.09</u>

American Elevator and Warehouse Company, Incorporated.

SCHEDULE 7.

Net Income.

Net income as disclosed by return.....	\$101,436.16
As corrected.....	101,816.72

Adjustment.....	\$380.56
Unallowable deductions and additional income:	
(a) Adjustment for real estate and personal property.....	<u>\$380.56</u>
Adjustment as above.....	<u>\$380.56</u>

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SCHEDULE 8.

Explanation of Items Changed.

(a) An adjustment of \$380.56 has been made representing the difference between the prepaid taxes at August 31, 1928 and August 31, 1929.	
Inventory prepaid taxes August 31, 1928.....	\$5,879.20
Inventory prepaid taxes August 31, 1929.....	6,259.76
Increase.....	\$380.56

Since your corporation is on the accrual basis, the above adjustment is incorrect and has been reversed.

Occident Terminal Company.

SCHEDULE 9.

Net Income.

Net income as disclosed by return.....	\$200,300.74
As corrected.....	202,656.68
Adjustment.....	\$2,355.94
Unallowable deductions and additional income:	
(a) Adjustment for real estate and personal property taxes..	\$2,355.94
Adjustment as above.....	\$2,355.94

SCHEDULE 10.

Explanation of Items Changed.

(a) The adjustment for real estate and personal property taxes has been made as follows:

Amount deducted on return.....	\$42,518.62
Amount of deduction allowable.....	40,162.68
Excessive deduction disallowed.....	\$2,355.94

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SCHEDULE 11.

Consolidated Net Income.

Russell-Miller Milling Company, schedule 1.....	\$711,363.36
Occident Elevator Company, schedule 3.....	305,831.61
Electric Steel Elevator Company, schedule 5.....	162,851.66
American Elevator and Warehouse Company, Incorporated, schedule 7.....	101,816.72
Occident Terminal Company, schedule 9.....	202,656.68
Total consolidated net income.....	\$1,484,520.03

SCHEDULE 12.

Computation of Tax.

Net income.....	\$1,484,520.03
Income tax at 12%.....	178,142.40
Income tax at 11%.....	163,297.20
That proportion of the tax computed at 1928 rates which the number of months in 1928 is of the months of the year (4 months).....	\$59,380.80
That proportion of the tax computed at 1929 rates which the number of months in 1929 is of the months in the year (8 months).....	108,864.80
Total tax liability.....	\$168,245.60
Tax previously assessed, account # 430001.....	\$172,731.12
Less amount abated.....	9,596.17
	163,134.95
Deficiency.....	\$5,110.65

16 [Stamp:] Received Oct. 7, 1931, U. S. Board of
Tax Appeals.

[Stamp:] United States Board of Tax Appeals. Filed
Oct. 7, 1931.

United States Board of Tax Appeals.

Docket No. 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Answer.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that the respondent erred in the manner alleged in paragraph 4 of the petition.

5(a) and (b). Denies the allegations of fact contained in sub-paragraphs (a) and (b) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

Wherefore it is prayed that petitioner's appeal be denied.

(Signed)

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

O. J. TALL,
Special Attorney,
Bureau of Internal Revenue.

amm.

10-7-31.

17 [Stamp:] United States Board of Tax Appeals.
Filed Aug. 18, 1932.

United States Board of Tax Appeals.

Docket No. 59998.

RUSSELL MILLER MILLING Co., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Agreed Stipulations of Fact.

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true, and provided further that either party may object to the consideration of any facts herein stipulated on the ground of immateriality, irrelevancy, and incompetency.

1. The Russell Miller Milling Company is a corporation organized under the laws of the State of North Dakota, with its principal office in Minneapolis, Minnesota, is engaged in the milling of wheat flour, and was so engaged in the years 1925, 1926, and 1927.

18 2. Petitioner's books of account were kept on the accrual method of accounting during the years herein mentioned, and on the basis of a fiscal year ending August 31, for each year, and its federal income tax returns were likewise prepared and filed on the accrual basis, for fiscal years ending August 31 in each case, and were approved by the Commissioner of Internal Revenue in these particulars.

3. During its fiscal year ending August 31, 1927, petitioner was called upon by the Department of Inland Revenue for Great Britain, to make its return of Income Taxes Payable to Great Britain for the years 1925-26, and 1926-27. The Department of Inland Revenue aforesaid demanded audited accounts showing the profit or loss upon such sales;

and, upon being advised that petitioner was unable to supply such accounts, sent assessments as follows:

1925/26	£40
1926/27	200
1927/28	40
Total	£280

4. Petitioner denied any liability for such taxes, on the grounds, first, that petitioner was not trading in Great Britain, and was not subject to tax upon profits from sales made in that country and, second, that even tho it was held that petitioner was trading in Great Britain, no profit had been earned upon sales made there.

5. In October, 1928, petitioner was advised by its London Agent that if said petitioner would admit its liability the Department of Inland Revenue might be willing to modify the above assessments to the following amounts:

1925/26	£20
1926/27	100
1927/28	None
Total	£120

19 On October 30, 1928, petitioner authorized its London Agent to settle on this basis, and on November 20, 1928, cabled £120, in payment of the amount agreed upon, the rate of exchange paid for this amount being \$4.855, making a total payment of \$582.60.

6. During its fiscal years ending August 31, 1926, 1927, and 1928, petitioner did not accrue or enter upon its books of account any amount for such Income Taxes payable to Great Britain, and made no claim in its Federal Income Tax Returns for said fiscal years, for a deduction for such taxes, or for credit for Taxes Paid or Accrued to a Foreign Country.

7. To its income tax return for its fiscal year ended August 31, 1929, petitioner attached Form 1118, claiming credit of \$582.60 for Taxes paid to a Foreign Country,

which claim for credit has now been denied and disallowed by the Commissioner.

EARLE W. WALLICK,

Attorney for Petitioner.

(Signed) C. M. CHAREST,

General Counsel,

Bureau of Internal Revenue,

Counsel for Respondent.

E. S. C.

SLY.

8-18-32.

20

27 B. T. A. —.

United States Board of Tax Appeals.

Docket No. 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Promulgated December 21, 1932.

A taxpayer keeping its books and reporting its income on the accrual basis is not entitled under the statute to postpone the taking of credits for taxes paid to a foreign country beyond the year of accrual.

Ben Jenkins, Esq., and Earle W. Wallick, Esq., for the petitioner.

E. L. Corbin, Esq., for the respondent.

Opinion.

SMITH:

This proceeding involves a deficiency in petitioner's income tax for the fiscal year ended August 31, 1929, in the amount of \$5,110.65. The only question at issue is whether the petitioner is entitled to a credit against its tax liability for the taxable year 1929 of \$582.60, representing income taxes paid to the British Government in that year on income of the prior years 1925, 1926, and 1927. The respondent has disallowed the credit for the

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petitioner's taxable year ended August 31, 1929, for the stated reason that since the petitioner kept its books and accounts on the accrual basis the credits for the foreign taxes must be taken on the accrual basis and not in the year of payment. The material facts are stipulated, as follows:

1. The Russell Miller Milling Company is a corporation organized under the laws of the State of North Dakota, with its principal office in Minneapolis, Minnesota, is engaged in the milling of wheat flour, and was so engaged in the years 1925, 1926, and 1927.

2. Petitioner's books of account were kept on the accrual method of accounting during the years herein mentioned, and on the basis of a fiscal year ending August 31, for each year, and its federal income tax returns were likewise prepared and filed on the accrual basis, for fiscal years ending August 31 in each case, and were approved by the Commissioner of Internal Revenue in these particulars.

3. During its fiscal year ending August 31, 1927, petitioner was called upon by the Department of Inland Revenue for Great Britain, to make its return of Income Taxes payable to Great Britain for the years 1925-26, and 1926-27. The Department of Inland Revenue aforesaid demanded audited accounts showing the profit or loss upon such sales; and, upon being advised that petitioner was unable to supply such accounts, sent assessments as follows:

1925/26	£40
1926/27	200
1927/28	40
Total	£280

4. Petitioner denied any liability for such taxes, on the grounds, first, that petitioner was not trading in Great Britain, and was not subject to tax upon profits from sales made in that country and, second, that even tho it was held that petitioner was trading in Great Britain, no profit had been earned upon sales made there.

22 5. In October, 1928, petitioner was advised by its London Agent that if said petitioner would admit its liability the Department of Inland Revenue might be willing to modify the above assessments to the following amounts.

1925/26	£20
1926/27	100
1927/28	None.
Total	£120

On October 30, 1928, petitioner authorized its London Agent to settle on this basis, and on November 20, 1928, cabled £120, in payment of the amount agreed upon, the rate of exchange paid for this amount being \$4.855, making a total payment of \$582.60.

6. During its fiscal years ending August 31, 1926, 1927, and 1928, petitioner did not accrue or enter upon its books of account any amount for such Income Taxes payable to Great Britain, and made no claim in its Federal Income Tax Returns for said fiscal years, for a deduction for such taxes, or for credit for Taxes Paid or Accrued to a Foreign Country.

7. To its income tax return for its fiscal year ended August 31, 1929, petitioner attached Form 1118, claiming credit of \$582.60 for Taxes paid to a Foreign Country, which claim for credit has now been denied and disallowed by the Commissioner.

Section 131 of the 1928 Act provides with respect to credits for foreign taxes, in part as follows:

Taxes of Foreign Countries and Possessions of United States.

(a) Allowance of Credit.—The tax imposed by this title shall be credited with:

(1) Citizen and Domestic Corporation.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

* * * * *

(c) Adjustments on Payment of Accrued Taxes.—If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner, who shall redetermine the amount of the tax for

the year or years affected, and the amount of tax due
23 upon such redetermination, if any, shall be paid by
the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 322. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as the Commissioner may require, conditioned upon the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(d) Year in Which Credit Taken.—The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis.

Section 43 of the Act provides that—

Period for Which Deductions and Credits Taken.—The deductions and credits provided for in this title shall be taken for the taxable year in which “paid or accrued” or “paid or incurred”, dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

See also the corresponding sections 238 and 200 (d) of the 1926 Act.

A taxpayer keeping its books and reporting its income upon the accrual basis is required to report in each year all items of income or expenses properly accruable in that year; otherwise, the taxpayer's true income will not be reflected by such bookkeeping method. See *United States v. Anderson*, 269 U. S. 422; *Aluminum Castings Co. v. Routzan*,

282 U. S. 92, *Continental Tie & Lumber Co. v. United States*, 286 U. S. 290; 52 S. Ct. 529; *Ernest M. Bull, Exr.*, 7 B. T. A. 993; *Columbia Carbon Co.*, 25 B. T. A. 456; *Permanent Homes Land Co.*, 27 B. T. A. 142. This doctrine of accruals

is applicable also in determining the year in which
24 the statutory credits for foreign taxes may be taken.

See *Mead Cycle Co.*, 10 B. T. A. 887; *W. J. Burns*, 12 B. T. A. 1209; *Columbian Carbon Co.*, *supra*. See also section 43 of the 1928 Act, quoted above.

With the exception provided for in section 131 (d) above, a taxpayer is required to apply the credit for foreign taxes allowed under section 131 of the Act, either in the year when "paid," if reporting its income upon the cash receipts and disbursements basis, or in the year when "accrued," if reporting on the accrual basis. The exception mentioned in section 131 (d) permits a taxpayer at his option to accrue the credit prior to the year of actual payment, even if reporting on a cash basis, but does not authorize a taxpayer reporting on the accrual basis, as was the petitioner, to postpone taking the credit until the foreign taxes are actually paid in a subsequent year. We cannot extend the scope of the statute by implication.

The petitioner contends, however, that, as a matter of correct accounting under its accrual method, the taxes paid to the British Government in its taxable year ended August 31, 1929 were not accruable expense items of the prior years for which they were levied, because the petitioner
25 did not admit its liability for any part of the taxes in the prior years. We do not know upon what grounds the taxpayer, in the prior years, denied its liability for the taxes, whether with good reason or otherwise. The facts demonstrate that the petitioner in 1929 admitted its liability, still for reasons not shown, and in a compromise agreement the amount of the tax originally proposed was reduced slightly more than half.

We cannot suppose, however, that the petitioner's liability for the taxes was in any sense contingent upon its own recognition of the claim of the British Government or that the liability was any less fixed and certain because of the petitioner's failure to admit it. In *United States v. Anderson, et al.*, *supra*, the Supreme Court said:

Only a word need be said with reference to the contention that the tax upon munitions manufactured and sold

in 1916 did not accrue until 1917. In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books. * * *

The agreed facts in evidence here do not show just when the taxes in question became due and payable or when they were assessed by the British Government, but, of whatever materiality this may be, it appears that these events took place prior to the taxable year ended August 31, 1929. Certainly, all of the events had occurred which fixed the amount of the tax due to the British Government and determined the liability of the taxpayer to pay it.

26 We are of the opinion that the credits for the taxes in question were accruable in the prior years and may not be taken when actually paid in the taxable year ended August 31, 1929.

Reviewed by the Board.

Judgment will be entered for the respondent.

27 United States Board of Tax Appeals, Washington.
Docket No. 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Decision.

Pursuant to the determination of the Board, as set forth in its report promulgated December 21, 1932, it is

Ordered and decided that there is a deficiency of \$5,110.65 for the fiscal year ended August 31, 1929.

Enter.

Entered Dec. 22, 1932.

(Signed)

CHARLES P. SMITH,
Member.

28 [Stamp:] United States Board of Tax Appeals.
Filed Mar. 14, 1933.

United States Board of Tax Appeals.

Docket Number 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

Stipulation.

It is hereby stipulated and agreed, by and between the parties hereto, through the undersigned, their respective attorneys, that, in accordance with Section 1002 of the Revenue Act of 1926, the above entitled cause may be appealed, in accordance with Section 1001 of the Revenue Act of 1926, to the Court of Appeals of the District of Columbia.

DAVID J. SHORB,

Attorney for Petitioner,

537 Woodward Building, Washington, D. C.

C. M. CHAREST,

General Counsel,

Bureau of Internal Revenue.

Dated January 30, 1933.

29 [Stamp:] United States Board of Tax Appeals.
Filed Mar. 14, 1933.

In the Court of Appeals of the District of Columbia,
October Term, 1932.

No. —.

RUSSELL-MILLER MILLING COMPANY, Appellant,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Appellee.

*Petition for Review of Decision of the United States Board
of Tax Appeals.*

To the Honorable the Chief Justice and the Associate Justices of the Court of Appeals of the District of Columbia:

Your petitioner, the Russell-Miller Milling Company, respectfully shows:

I.

Jurisdiction for Review.

This is a proceeding for review by the Court of Appeals of the District of Columbia, of a decision of the United States Board of Tax Appeals, entered December 22, 1932, and redetermining a deficiency in income tax against your petitioner, for the fiscal year ended August 31, 1929, in the amount of Five Thousand One Hundred and Ten Dollars and Sixty-five Cents (\$5,110.65).

On the 30th day of January, 1933, counsel for the appellant and counsel for appellee entered into an agreement under and pursuant to the provisions of Section 1002(d) of the Revenue Act of 1926, that said decision of the United States Board of Tax Appeals may be reviewed by this Court.

30

II.

Your petitioner is a corporation organized and existing under the laws of the State of North Dakota, and having its principal office and place of business in Minneapolis, Minnesota.

III.

Nature of Controversy.

1. On September 22, 1931, the appellant filed with the United States Board of Tax Appeals, in pursuance of the provisions of the Revenue Act of 1928, its petition (Docket No. 59,998) requesting the redetermination of a deficiency in income taxes for the fiscal year ended August 31, 1929, in the amount of Five Thousand One Hundred and Ten Dollars and Sixty-five Cents (\$5,110.65), as shown by the final notice of deficiency previously mailed by the appellee under date of August 20, 1931.

The controversy before the United States Board of Tax Appeals concerned only—

The propriety of the failure and refusal by the Commissioner of Internal Revenue to allow as a credit against the tax due to the United States for said fiscal year, British taxes accrued and paid in the amount of Five Hundred and Eighty-two Dollars and Sixty Cents (\$582.60).

With respect to this item, the petition alleged that in its fiscal year ended August 31, 1929, and on or about November 27, 1928, the appellant paid British Income Tax in the amount of Five Hundred and Eighty-two Dollars and Sixty Cents (\$582.60), based upon a compromise settlement by it accepted on October 30, 1928, of an assessment then made of £100 equalling £20 in tax for the year 1925-1926, and of £500 equalling £100 in tax for the year 1926-1927. In his determination of the deficiency proposed, the Commissioner refused to allow this payment of a tax imposed by a foreign country as a credit against the tax imposed upon the appellant's income by the Revenue Act of 1928.

2. On October 7, 1931, the appellee filed with the said Board his answer to the said petition, Docket No. 59,998, which answer admitted that the petitioner was a North Dakota corporation with its principal office at 424 Security Building, Minneapolis, Minnesota; that he had mailed to the appellant a notice of deficiency dated August 20, 1931; but denied each and every other fact alleged in said petition.

3. The cause being at issue under the rules of practice of said Board upon the filing of said answer, duly came on for hearing on September 26, 1932. At the said hearing, the appellant and the appellee presented to the Board an Agreed Stipulations of Fact, and upon the said Petition, Answer and Agreed Stipulations of Fact the case was submitted to the Board. Thereafter on December 21, 1932, the said Board of Tax Appeals, the final administrative agency in the Executive Branch of the Government, promulgated its findings of fact and opinion, affirming the determination by the Commissioner of Internal Revenue of the deficiency proposed, and on December 22, 1932, entered its decision, ordering and deciding that there is a deficiency in the amount of Five Thousand One Hundred and Ten Dollars and Sixty-five Cents (\$5,110.65), the amount hereinbefore set out in Paragraph I hereof.

32 The question here presented to this honorable Court is whether the action of the United States Board of Tax Appeals was proper under the law and the agreed facts.

IV.

Assignments of Error.

Your petitioner further shows that it is aggrieved by the action of said United States Board of Tax Appeals and injured thereby, and that the errors complained of are as follows:

1. That the Board of Tax Appeals erred in its finding that income taxes for the years 1925-6 and 1926-7, actually acknowledged by appellant and paid to Great Britain during the taxable year ended August 31, 1929, after any and all liability therefor had been continuously denied and contested theretofore, were accruable prior to said taxable year ended August 31, 1929.

2. That said Board erred in its finding that said income taxes did not accrue during the taxable year ended August 31, 1929.

3. That said Board erred in its finding that credit for said income taxes may not be taken against income taxes payable to the United States for the taxable year ended August 31, 1929, in accordance with Section 32 of the Revenue Act of 1928.

Wherefore your petitioner prays that this honorable Court may review said findings, opinion, decision and judgment, and reverse and set aside the same, and direct the said Board to modify and change its findings of fact and

33 opinion, and that the Clerk of the United States Board of Tax Appeals be directed to transmit and deliver to the Clerk of said court certified copies of all and every of the documents necessary and material to the presentation and consideration of the foregoing petition for review and as required by the rules of said Court and statutes made and provided; and that this Court may grant such other and further relief as may appear proper in the premises.

And your petitioner will ever pray.

RUSSELL-MILLER MILLING
COMPANY,
By DAVID J. SHORB,
Attorney for Appellant,
537 Woodward Building,
Washington, D. C.

34 CITY OF WASHINGTON,
District of Columbia, ss:

David J. Shorb, being duly sworn, says I am the Attorney for the petitioner-appellant in this proceeding. I prepared the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information, and belief. This petition is not filed for purposes of delay, and I believe the appellant is justly entitled to the relief sought.

DAVID J. SHORB.

Sworn to and subscribed before me this 14th day of March A. D. 1933.

[Seal of Mary E. Waldron, Notary Public, District
of Columbia.]

MARY E. WALDRON,
Notary Public.

(My commission expires July 3, 1934.)

35 [Stamp:] United States Board of Tax Appeals.
Filed Mar. 14, 1933.

United States Board of Tax Appeals.

Docket No. 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Præcipe for Transcript.

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of record in this cause, and on or before sixty days from the date of the filing of the petition for review, transmit the same to the Clerk of the Court of Appeals of the District of Columbia, including in said transcript copies, duly certified as correct, of the following documents:

1. The docket entries of proceedings before the Board in the above entitled cause;

2. Petition for redetermination, filed on September 22, 1931;

3. Answer to petition, filed October 7, 1931;

4. Agreed Stipulations of Fact, filed August 18, 1932;

5. Opinion, promulgated December 21, 1932;

6. Decision, entered December 22, 1932.

36 7. Agreement for review by the Court of Appeals of the District of Columbia, filed March 14, 1933;

8. Petition for review, filed March 14, 1933;

9. This præcipe for transcript.

Said transcript to be prepared as required by law and the rules of the Court of Appeals of the District of Columbia.

DAVID J. SHORB,
Attorney for Petitioner,
537 Woodward Building, Washington, D. C.

Service of a copy of the foregoing is hereby acknowledged this 14th day of March, 1933.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

37 United States Board of Tax Appeals, Washington.

Docket No. 59998.

RUSSELL-MILLER MILLING COMPANY, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Certificate.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 36, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Præcipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at

Washington, in the District of Columbia, this 13th day of April, 1933.

[Seal of U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk United States Board of Tax Appeals.

Endorsed on cover: Board of Tax Appeals. No. 5941. Russell-Miller Milling Company, appellant, vs. David Burnet, Commissioner of Internal Revenue. Court of Appeals, District of Columbia. Filed Apr. 20, 1933. Henry W. Hodges, Clerk.

(3307)

COURT OF APPEALS
DISTRICT OF COLUMBIA
FILED

JUN 15 1933

Henry W. Hodges

CLERK

IN THE

Court of Appeals, District of Columbia.

No. 5941.

THE RUSSELL-MILLER MILLING COMPANY,
APPELLANT,

v.

DAVID BURNET, COMMISSIONER OF
INTERNAL REVENUE.

Appeal from the United States Board of Tax Appeals.

BRIEF OF APPELLANT.

EARLE W. WALLICK,
DAVID J. SHORB,
BEN JENKINS,
Attorneys for Appellant.

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IN THE
Court of Appeals, District of Columbia.

No. 5941.

RUSSELL-MILLER MILLING COMPANY,
Appellant,
v.
DAVID BURNET, COMMISSIONER OF INTERNAL
REVENUE.

Appeal from the Board of Tax Appeals.

BRIEF OF APPELLANT.

JURISDICTION.

This is an appeal from a judgment entered by the United States Board of Tax Appeals on December 22, 1932 (p. 18), determining a deficiency in income taxes against appellant for the fiscal year ended August 31, 1929.

The judgment was entered after findings of fact and an opinion by the Board of Tax Appeals, acting through Board Member Smith, holding against appellant respecting the one issue before it (pp. 13-18).

QUESTION PRESENTED.

The appeal to this Court is upon the single matter: That there should have been allowed to appellant a credit against its income tax liability to the United States for the fiscal year ended August 31, 1929, for taxes accrued and paid to the Kingdom of Great Britain in that fiscal year in the amount of \$582.60. The three errors assigned (p. 22), and relied upon, are all respecting this one matter.

STATEMENT OF THE CASE.

Appellant's books of account are, and were during its fiscal years 1925, 1926, 1927 and 1929, kept on the accrual method of accounting, and on the basis of a fiscal year ending August 31 (p. 11). Likewise, its federal income tax returns were prepared and submitted and accepted by the Commissioner on these bases (p. 11).

During its fiscal year 1927, appellant was called upon by the Department of Inland Revenue for Great Britain to make returns of Income Taxes Payable to Great Britain for the taxable years 1925-26 and 1926-27. Audited accounts were demanded, appellant stated its inability to supply such audited accounts, and assessments were sent, £40 for 1925-26, £200 for 1926-27, and £40 for 1927-28. Appellant denied any liability for such taxes, first, because it asserted that it was not trading in Great Britain, and, second, that even if it was, it had earned no profit upon sales made there. On October 30, 1928, appellant authorized its London agent to accept the proposal of the Department of Inland Revenue to modify the assessments to £20 for 1926 and £100 for 1927, with nothing for 1928, and on November 20, 1928, a

date within its fiscal year ended August 31, 1929, cabled £120, \$582.60, the amount agreed upon. Appellant did not in its fiscal years 1926, 1927, and 1928 accrue or enter upon its books of account any amount for Income Taxes payable to Great Britain, and made no claim on its Federal Income Tax Returns for said fiscal years, for a deduction for such taxes, or for credit for Taxes paid or accrued to a foreign country.

To its income tax return for its fiscal year ended August 31, 1929, appellant attached Form 1118, to claim credit of \$582.60 for Taxes paid to a Foreign Country. The Commissioner of Internal Revenue denied and disallowed the credit so claimed, stating: "Since your books of account and records are kept on the accrual basis, credit for foreign taxes must be taken on an accrual basis, and not in the year of payment."

The opinion of the Board was that the credits for the taxes in question were accruable in the prior years and may not be taken when actually paid in the taxable year ended August 31, 1929 (p. 18).

STATUTES INVOLVED.

Credits for taxes paid to a foreign government are authorized by the several revenue acts, the provision of the 1926 Act being,—

"Sec. 238 (a). In the case of a domestic corporation the tax imposed by this title shall be credited with the amount of any income, war profits, and excess profits taxes paid or accrued during the same taxable year to any foreign country, or to any possession of the United States."

And Section 200 of the same Act provides in part, that,—

“(d). The terms ‘paid or incurred’ and ‘paid or accrued’ shall be construed according to the methods of accounting upon the basis of which the net income is computed under Section 212 or 232.”

The corresponding sections of the Revenue Act of 1928 are respectively 131 (a) (1):

“Sec. 131. Taxes of Foreign Countries and Possessions of United States.

(a) Allowance of Credit. The tax imposed by this title shall be credited with:

(1) Citizen and domestic corporation. In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States;
* * *”

And

“Sec. 43. Period for which Deductions and Credits Taken.

“The deductions and credits provided for in this title shall be taken for the taxable year in which ‘paid or accrued’ or ‘paid or incurred,’ dependent upon the method of accounting upon the basis of which the net income is computed unless in order to clearly reflect the income the, deductions or credits should be taken is of a different period.”

Section 32 of the 1928 Act provides:

“The amount of income, war profits, and excess profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax, to the extent provided in section 131.”

ARGUMENT.

I. Appellant Having Maintained its Books and Filed its Income Tax Returns on the Accrual Basis, was Allowed Ordinary Deductions from Gross Income as such Deductions Accrued.

To determine appellant's liability to the United States for income taxes for its taxable year 1929, its gross income is first determined; then, to determine taxable net income, deductions are allowed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer." (Section 41 of the 1928 Act.) As the Court well knows, there are two recognized bases of accounting, the cash receipts and disbursements basis and the accrual basis.

Appellant kept its books of account, and rendered returns of income tax liability upon the accrual basis for the years here involved (p. 11), therefore, in determining its taxable net income for any of those years, and more especially for its fiscal year ended August 31, 1929, whether or not an otherwise deductible expense had accrued was the sole test of its deductibility. Payment in that year was not a test, the only question asked was whether or not that expense had accrued, was it *due and payable*.

II. Appellant Having Maintained its Books and Filed its Income Tax Returns on the Accrual Basis, is to be Allowed Credit for Income Taxes Paid to Great Britain, in the Year in which such Taxes Accrued.

Such is the plain provision and requirement of the Income Tax statutes. Section 32 of the 1928 Act (*supra*) provides for a credit to the extent provided in

Section 131; section 131 (a) (1) requires that the income tax imposed by this title, not by some other title but "by this title" shall be credited with the amount of foreign taxes "paid or accrued"; and section 43 defines "paid or accrued" to provide that the term shall be construed according to the methods of accounting upon the basis of which the net income is computed. This provision of the taxing statutes we would particularly stress, in determining the credit for foreign taxes "paid or accrued" the term "paid or accrued" shall be construed according to the methods of accounting upon the basis of which net income is computed. That is, whether or not a given foreign tax shall be allowed as a credit, is to be determined by applying the same accounting tests as are applied to determine whether or not a given item is an allowable deduction from gross income.

While appellant within its fiscal year ended August 31, 1929, *paid* taxes in the amount of \$582.60 to Great Britain, we maintain that that fact in itself is of no consequence. We do not assert that the Commissioner should have allowed the credit because of the *payment*; we do not assert that the Board of Tax Appeals should have found that appellant was entitled to a credit of \$582.60 because it *paid* that amount in 1929. Our contention is, and shall be, that the Commissioner should have allowed the credit because the said taxes in the amount of \$582.60 accrued in fact and in law in the fiscal year ended August 31, 1929, and that the Board erred when it held that they were accruable in prior years, and may not be taken as a credit in the taxable year 1929. We do not assert appellant's right to the credit because of *payment* but because of *accrual*.

III. An Ordinary Expense is not Accrued for the Purpose of Determining its Deductibility, so Long as the Existence of any and all Legal Liability Therefor is Denied and Contested.

Where the books of account of a particular taxpayer are kept on the accrual basis of accounting, the test that is applied in determining whether or not a certain item may be deducted from the gross income of a definite taxable period is whether or not it had "accrued" in that taxable period, and the question that is answered is "when did the item accrue." We believe we correctly state the law when we say that an ordinary deduction from gross income has not accrued as a deductible item so long as any and all legal liability therefor is denied and contested.

In *LUCAS v. AMERICAN CODE CO.*, 280 U. S. 445, 50 S. Ct. 202, 746 ed. 538, the company had employed a sales manager for 18 years from January 3, 1919, compensation to be a commission based on sales. In May, 1919, it discharged him, for alleged cause. In July, 1919, he brought suit for wrongful discharge, claiming \$100,000.00 damages. Affirmative defenses were interposed and liability was contested. In October, 1919, the company notified the Commissioner of the suit and asked leave to deduct in its income tax return an amount equal to the commissions for 1919 computed on the contract basis. Permission was refused but the company set up on its books, at the close of the year, a reserve equal to (448) the amount of such commissions, \$14,764.79. At the end of 1920, it increased the reserve to \$32,994.09, on the same basis. In 1922, there was a jury trial, judgment was entered for \$21,019.19, which was affirmed by the appellate division. In 1923, on appeal to the Court

of Appeals the judgment was affirmed, and in that year the company paid the judgment. The judgment having been rendered by the trial court early in 1922 before the books were closed for 1921, the reserve set up was adjusted as of the close of 1921 to the amount of the recovery, \$21,019.19, and the controversy was as to the deductibility of that sum from gross income for 1919.

Mr. Justice Brandeis, in deciding the case, showed that the books were kept on the accrual basis, and referred to the fact that the Circuit Court of Appeals for the Second Circuit, 30 F. (2d) 222, had reversed the Board of Tax Appeals, and sustained the argument of the company that

“Since the breach of the contract occurred in 1919, all the facts which gave rise to the liability were fixed in that year; that damages must be assessed as of the date of the breach; that the loss therefore occurred in that year; and that it is immaterial that the amount of the damages was not determined or paid until later.”

And the company specifically invited attention to a provision of law for the filing of an amended return and claim for refund where the amount of a loss ascertained in a subsequent year had not been taken as a deduction from gross income in a prior year.

The opinion of the Supreme Court was that

“It can not be said that the loss actually paid by the company in 1923 was, as a matter of law or of undeniable fact, sustained in 1919. Nor did the company so regard it.”

And in reaching the opinion, Mr. Justice Brandeis referred to the fact that at the time of its breach the

contract still had 18 years to run; that liability for the breach was denied and strenuously contested; that the amount of the damages, if any, was wholly unpredictable; that while the facts determining liability had occurred in the year of the breach, the amount to be recovered, if there was legal liability, depended in large part on the course of future events; and finally, that the company did not accrue on its books within the tax year, a liability in the estimated amount of the loss, the reserve it did set up having no relation to the apprehended total loss, constituting simply the amount of commissions which would have been payable in that year if the employee had remained in its service.

The Supreme Court found that the Board of Tax Appeals had correctly construed the law, and it said,—

“The Board of Tax Appeals has held, in a series of well-reasoned opinions, that a loss, occasioned by the taxpayer’s breach of contract is not deductible in the year of the breach, except under the special circumstances where, within the tax year, there is a definite admission of liability, negotiations for settlement are begun, and a reasonable estimate of the amount of the loss is accrued on the books.”

No higher approval of the Board’s determinations may be had, therefore we would call to the attention of the Court, other decisions by the Board, and, first, one written by the Member from whose decision we now appeal. In *THORNE, NEALE & COMPANY, INC., v. COMMISSIONER*, 13 B. T. A. 490, there was presented to the Board the case of a petitioner engaged in the wholesale coal trade. It had retained freight cars beyond a given period, and, under regulations and orders of the Interstate Commerce Commission, was charged by railroad companies with

demurrage. The demurrage bills, the company was advised, were illegal and uncollectible, and it did not charge them to expense in the year in which they were rendered to it but set up a memorandum account. The matter was adjudicated before the Interstate Commerce Commission, and, upon the Commission's decision, the company paid the demurrage liability in subsequent years. The Commissioner of Internal Revenue contended that the coal company became liable for the demurrage charges in 1919 and that in its return for that year it should have accrued the liability and deducted from gross income the amount of the charges as an ordinary and necessary expense of doing business; that the demurrage bills were in accordance with the law and regulations; and that the company had no reasonable ground for questioning their correctness. The company, in opposition, contended that it had good ground for contesting the charges and showed that the Interstate Commerce Commission made a reduction. The *Thorne case*, of course, involved a determination of gross and net income but in that determination there was necessarily involved the matter of "accruals" and of the Section of the 1918 Act that corresponds to Section 200 of the 1928 Act, *supra*.

In its opinion in the *Thorne case* the Board finds that it has made many decisions as to the circumstances under which the taxpayer keeping its books upon an accrual basis must accrue a liability in the year in which the transaction occurred out of which the liability arose, and as to the circumstances under which a taxpayer must accrue it only in the year when the liability is finally determined, either with or without court adjudication and then the Board declares this to be the rule (p. 494):

“The sound rule established is that where the taxpayer acting in good faith disputes the liability and does not enter the item as a liability as of the year in which the transaction occurred out of which the liability arose the taxpayer can not take the deduction in that year but must take the deduction when the liability is finally taken or admitted.”

Continuing in its opinion, the Board said:

“We think it is clear that there is no election in a taxpayer to shift at his convenience the year in which the deduction for expenses must be taken merely by disputing the liability where there is no reasonable ground to deny a liability.”

But the Board then proceeds to say,—

“It does not follow, however, that where a taxpayer in good faith and on reasonable grounds disputes the liability he must nevertheless charge himself with the liability on his books and render tax returns accordingly. A taxpayer operating a large number of trucks in a populous city might have many claims filed against it for damages both to the person and to property. Some of these claims may be entirely groundless. We think it can not be maintained that merely because the taxpayer may be subject to a liability on some of these claims he should charge himself with a liability prior to the date the amount thereof is actually ascertained.”

Further, the opinion of the Board member in the *Thorne case* goes on to state that,—

“A taxpayer is entitled to report income for taxation on the same sound business judgment on which he keeps his books for business purposes.

If in good faith he does not recognize a claim as a valid claim against him it is not an accrued liability. To hold that every liability asserted against a taxpayer and, independently of whether it was reasonably based, must be taken as a deduction from income of the year when asserted, would lead to just as impossible results as would result from allowing a taxpayer, merely by questioning an undisputed liability, to shift at his election the year in which the deduction may be taken." (Italics ours.)

In its opinion in the *Thorne case*, the Board cited the case of the *Consolidated Tea Co., Inc. v. Bowers, Collector*, 19 Fed. (2d) 382. (S. D. N. Y.). In that case, the books of the Tea Company were kept on the accrual basis. In 1919, a court judgment for \$10,012.57 was entered against it for services rendered, and on December 31, 1919, it set up on its books a reserve for judgment and a like debit to profit and loss account. On its return it claimed as a deduction the amount of the judgment which had been entered against it during that year. The Commissioner disallowed this item as a deduction in 1919, but allowed it for 1921, when the judgment was affirmed by the Appellate Court. By reason of the difference in tax rate, Tea Company was compelled to pay additional taxes of \$1,572.21 and for that amount it brought suit.

The court's verdict was for the Collector, and in its opinion the Court says,—

"In the case at bar the Consolidated Tea Company, Inc., did not part with the control of the money in 1919; it had the use of it until 1921, when the judgment was affirmed and paid."

Continuing, the District Court for the Southern District of New York said:

“From a tax income standpoint, both logical and practical reasons seem to me to support the conclusion that a loss should be deductible, not in the year when the judgment was rendered, but in the year when the claim was adjudicated to be final and definite, or possibly, under certain circumstances, in the year when the claim originated.”

In *GRAHAM-BUMGARNER CO. v. COMMISSIONER*, 11 B. T. A. 603, the petitioner had received payments in 1919 under an agreement cancelling a war-supply contract made between April 6, 1917, and November 11, 1918. Its accounting was on the accrual basis, and its contention was that since it was on the accrual basis, the amount so received in 1919, or at least a part of it, represented a valid claim against the Government at the close of 1918 and, therefore, should have been accrued and reported as income in 1918. In declining to give its assent to the petitioner's contention, Mr. Littleton said:

“To this we can not assent. The most that can be said is that in 1918 petitioner had a contract with the Government, and that upon the signing of the Armistice petitioner was ordered to stop work under the contract. At the close of 1918, there had been no recognition of liability on the part of the Government to make any payments for work done, or expenditures made, under the contract. While it might be reasonable to assume that petitioner could have expected, when the work was ordered stopped, that it would be reimbursed in some manner, there was no assurance of this fact and, consequently, no basis on which an accrual of income could then have been predicated.”

In *BUFFALO UNION FURNACE CO. v. COMMISSIONER*, 23 B. T. A. 439, the Board considered these circumstances: Petitioner performed certain switching service from 1905 to 1914, without receiving payment therefor, when its competitors were either receiving payment for rendering such service or the service was being rendered for them without charge. In 1911 the Interstate Commerce Commission found that the discriminatory practice existed and in 1917 ordered the railroads to pay the petitioner the cost of rendering such service from 1905 to 1914. The railroads, however, refused to pay and suits were instituted by petitioner to enforce collection. The suits were compromised in 1920, through payment to petitioner of approximately one-half of the cost found by the Interstate Commerce Commission. The Board held that the entire amount received constituted income when received in 1920.

The Commissioner's contention was that the entire amount is taxable income in the year when received as compensation for service performed in prior years, which compensation was not finally fixed and determined as a definite liability until the year when received; the petitioner contended that the amount received had accrued prior to its receipt and, therefore, should be accounted for as income prior to 1920. In 1917 the I. C. C. had entered a final decree fixing the damages suffered and ordered the railroads to pay. But, says the Board, "This order was not self-executing; if the railroads refused to pay, which they did, the petitioner's remedy was an action at law wherein the Commission's findings were *prima facie*, but not conclusive evidence, subject to countervailing evidence." The railroads refused to pay, petitioner brought suits for collection, and before trial a compro-

mise was effected through which petitioner received in 1920 in full satisfaction of the damage suffered approximately one-half the amount that had been fixed by the Commission.

In another case, CLARK DREDGING COMPANY *v.* COMMISSIONER, 23 B. T. A. 503, one of the points at issue involved these facts:

On March 24, 1924, the petitioner entered into a contract with the Government of the Bahama Islands, for dredging the channel and turning basin at the harbor of Nassau. The work was to be completed within sixteen months, or by July 24, 1925. The contract contained a provision obligating the contractor to pay as and for liquidated damages, and not by way of penalty, the sum of 100 pounds for each and every completed week which should elapse between the date prescribed for completion and the date on which the work was actually completed, such damages to be deducted from any money due the contractor or to be recovered from the contractor as a debt. The work was not completed in 1925 or in 1926.

The Government of the Bahamas notified petitioner of the amount due it for failure to complete the work in time, but it did not withhold any payments due the petitioner or demand payment. A supplemental contract was entered into some time after 1926.

The DREDGING COMPANY claimed as a deduction from its 1925 income the accrual of liquidated damages of one-hundred pounds per week provided by the contract for delay in performance, but the Board found that the amount was not deductible in 1925, it appearing that there was no demand for payment *or admission of liability*.

This well-defined position of the Board of Tax

Appeals respecting deductions from gross income, has been contested, and unsuccessfully, by appeals to the Circuit Courts. In the case of *J. N. PHARR & SONS, LIMITED, v. COMMISSIONER*, 21 B. T. A. 245, there had been a breach of contract to sell over a million pounds of sugar at 11.76 and 12 cents per pound, where after the making of the contracts the Food Administration had authorized a maximum price of 18 cents per pound. Damage suits followed, there was recovery of judgment on one in 1920, and that judgment was affirmed by the Fifth Circuit in 1921. The other suits were compromised in 1924 and 1927. The Board held that the amounts represented by the claims could not be deducted in computing income for 1919. In sustaining the decision of the Board, the appellate court said (56) F. (2d) 832:

“Under a regulation of the Treasury Department, an amount paid pursuant to a judgment is deductible when the claim is put in judgment or paid. That is a reasonable regulation, as it tends to make income tax returns reasonably certain and definite. We think the question involved is settled adversely to petitioner by *Lucas v. American Code Co.*, 280 U. S. 445, 50 S. Ct. 202, 74 L. Ed. 538.”

This Court was called upon in *PRICE IRON & STEEL CO. v. BURNET*, 45 F. (2d) 921, to consider a case that presented this same general question, and where the Board had maintained its position respecting such claims for deductions from gross income. It appeared that during 1918, 1919 and 1920, the taxpayer had purchased large quantities of scrap metal. In 1924 the sellers demanded additional payment on account of wrongful classification and grading, and the claim was settled and paid in 1925. This court

held that such payment could not be considered as additional cost of goods sold in 1920, because the taxpayer kept its books on the accrual basis and goods purchased in 1920 were fully paid for according to the classification recognized at that time, and the transaction in 1925, if deductible at all, would belong in the return for 1925, and not for 1920. What occurred in 1925 was a separate transaction, that could not relate back to 1920 in such manner as to be regarded as an additional part of the purchase price of the goods for that year.

Then, and along exactly this same line, there came to the Board a petition for redetermination, where the controversy was respecting an item of income, rather than as to whether there could be a deduction from income. The Board did not there follow its declarations of principle respecting accruals, but allowed income received in a later year to be accrued in 1921 and included in income for that year. This time the Commissioner appealed from the Board's decision and the Fifth Circuit held that a mere contingent claim of gain, especially a contested one, should be subjected to the same tests as would be applicable in the case of a loss. This is the case of

SOUTHEASTERN EXPRESS CO. *v.* COMMISSIONER, 19 B. T. A. 490, where the express company accrued upon its books of account, kept upon the accrual basis, certain charges against the American Railway Express. The latter company refused to pay. On appeal to the Interstate Commerce Commission the contentions of the express company were upheld. American Railway Express appealed to the courts and secured an order enjoining enforcement of the order of the I. C. C. The litigation went to the Supreme Court, which reversed the order of the lower court, thereby reinstating the order of the Commission.

American Railway Express then paid the charges made against it for 1921. The Board of Tax Appeals held that the charges were proper accruals for 1921, saying:

“We are of the opinion that much weight should be given to the books of account of the taxpayer kept in good faith. The petitioner accrued the \$51,300 in question on its books of account in 1921 and returned the income for that year. We believe that its return made upon such basis correctly reflected its income upon the accrual basis, so far as the \$51,300 in question is concerned.”

However, the Commissioner was dissatisfied with the decision of the Board, and carried the case to the Circuit Court of Appeals, Fifth Circuit, and that court remanded the case to the Board, 56 F. (2d) 600, because:

“It follows that the Southeastern in 1921 had only a claim which ripened into a definite right in a later year. A mere contingent claim, especially a contested one, whether of loss or gain, may never be sustained or realized: it is too uncertain to be considered in making up an income tax return. *Lucas v. American Code Co.*, 280 U. S. 445, 50 S. Ct. 202, 74 L. Ed. 538; *Lucas v. North Texas Lumber Co.*, 281 U. S. 11, 50 S. Ct. 184, 74 L. Ed. 668; *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115, 50 S. Ct. 273, 74 L. Ed. 733.

The Board's position respecting deductions from gross income is well defined; that if a taxpayer acting in good faith disputes a liability he may not then deduct an accrual but must wait until there has been a final determination. The Circuit Courts have affirmed findings under that principle and have reversed a finding respecting income that was contrary

to the principle established. Both appellate courts cited *Lucas v. American Code Co.* (*supra*). In that case the Board had adhered to the general principle, and its decision had been reversed by the Second Circuit, 30 F. (2d) 222. The Supreme Court granted certiorari, and on consideration of the case reversed the decision of the Circuit Court which had found that the Board had incorrectly determined the law, thereby giving its stamp of approval to the established principle that a contested and disputed loss has not accrued until there has been the final determination.

IV. A Foreign Tax is not Accrued, for the Purpose of Determining its Allowability as a Credit, so long as the Existence of Any and All Legal Liability Therefor is Denied and Contested.

We maintain that this is the law because,

The same provision of the taxing statute governs the accrual of foreign taxes as governs deductions of ordinary expenses. The various internal revenue acts prescribe that the term "paid or accrued" shall be construed according to the methods of accounting upon the basis of which net income is computed. (Sec. 43 of the Revenue Act of 1928 (*supra*)). That construction is applicable both to deductions from gross income and to credits for taxes "paid or accrued" to a foreign country. In both sections the language is "paid or accrued," and the construction to be given to the words is prescribed, definitely and with certainty.

There is no fundamental distinction in character between the usual expenses of conducting a business and the expenses of that business for taxes, domestic or foreign. Both of them are recognized expenses,

they are so recognized by the taxing statutes, and the provisions respecting deductibility from gross income or allowability as a credit are exactly the same, they shall be allowed when "paid" or when "accrued" "according to the method of accounting upon the basis of which the net income is computed," and not otherwise.

Therefore, let us apply to the appellant's case the language of the Board and the Courts in the cases we have already cited. Respecting these credits, there appears to be no reason why the same rule should not apply as to them. By the terms of the statute they are given the same accounting status, therefore, the same rule must govern, and that rule, the Board, in the *Thorne case* (*supra*) says is:

"The sound rule established is that where the taxpayer acting in good faith disputes the liability and does not enter the item as a liability as of the year in which the transaction occurred out of which the liability arose the taxpayer can not take the deduction in that year but must take the deduction when the liability is finally taken or admitted."

The good faith of this appellant taxpayer has not been questioned, and surely its contentions, that it was not trading in Great Britain, and that, even if it was trading in that country, it had earned no profit upon any sales made there, were sufficient grounds for its action in disputing the liability and for questioning the correctness of the tax liability proposed by the Bureau of Internal Revenue.

In the *Thorne case*, the Board stated that it thought it to be clear that a taxpayer could not at his own convenience shift the year of a deduction merely by disputing liability without reasonable ground for so

doing. Immediately, the Board qualified that statement when it said:

“It does not follow, however, that where a taxpayer in good faith and on reasonable grounds disputes the liability he must nevertheless charge himself with the liability on his books and render tax returns accordingly.”

There has been and is no questioning of the good faith of appellant in disputing liability for the tax proposed by the Bureau of Internal Revenue, and certainly no taxpayer could have more reasonable and stronger grounds for disputing liability than the contention that it had not traded in Great Britain, and even if it had it had earned no profit there. In fact, we believe that, had appellant accrued the liability on its books and deducted the accrual in the prior years the Commissioner would have disallowed the deduction, and that if it had then taken an appeal to the Board of Tax Appeals the only answer it could have expected from the Board would have been an answer in accord with the Board's opinion in the *Thorne case*; and in support of that opinion it should be noted that the Board cited no less than 12 cases which had been before it wherein the taxpayer had disputed liability and wherein the Board had ruled that the deduction must be taken in the year when the liability was determined,—that it could not be taken in the year when the transaction occurred, the dispute as to the liability being reasonable. And in some of the cases cited by the Board the taxpayer had so completely accepted some liability as to enter the liability on its books of account.

This Court is not uninformed as to the present difficulties of Cook County and the City of Chicago,

Illinois, because taxpayers have not paid the taxes assessed. Some of these taxpayers have disputed liability, and, inevitably in the determination of the net taxable income of those taxpayers for Federal income tax purposes, questions have arisen as to the deductions from gross income to be allowed taxpayers on the accrual basis of accounting. An examination of the public files of the Board, discloses that appeals are pending where the Commissioner has disallowed as deductions from gross income, accruals of real estate taxes by taxpayers domiciled in Cook County, Illinois (Docket Nos. 70673, 70139, and 69,739 are instances) and, in other cases, where the Commissioner has disallowed the portion accrued but not in fact paid, treating the unpaid portion as a contingent liability (Docket No. 70312.)

Furthermore, had appellant claimed credit for these foreign taxes in the prior years, it would have been required to attach to its return, Form 1118, "Statement in Support of Credit Claimed on Corporation Income Tax Return for Taxes Paid or Accrued to a Foreign Country or a Possession of the United States." Schedule "A" of that form requires that to the form there be attached, as evidence, the receipt for taxes paid, or a copy of the return if an accrual was claimed, the instructions on the form being,—

"Instructions. 27. If a credit is claimed by a domestic corporation in Item 32 on account of income tax paid to a foreign country or a possession of the United States, submit Form 1118 with this return, together with the receipt for each such tax payment. In case credit is sought for taxes accrued the form must have attached to it a certified copy of the return on which each such accrued tax was based, * * *."

In the years prior to 1929, appellant's position was that it had had no income from any business it may have had in Great Britain, the most that it could have accrued would have been a "contingency," and it did not then admit even so much as a "contingency," and with no evidence that it could attach to Form 1118, there was no warrant in fact or in law for an accrual, and we assert, on the authority of the cases we have cited, and the known action by the Commissioner in the Cook County, Illinois, cases now pending, that had the appellant made an accrual of any amount, that accrual would not have been allowed as a credit. Any amount that might have been selected to be accrued would have been a pure guess, not even a contingency, and appellant would have been absolutely without evidence to present to a revenue agent, or to the Commissioner of Internal Revenue.

In the *Consolidated Tea Company case* (*supra*), the District Court referred to the fact that though the company claimed a deduction in 1919, it did not part with control of the money in that year, but had the use of it until 1921, when the judgment was affirmed and paid. By the same token, the Russell-Miller Milling Company did not part with control of the money it paid to Great Britain until 1929, and it did not set up any amount on its books before that year.

There is such a similarity of basic facts in the *Buffalo Union Furnace Co. case* (*supra*) and in the case here presented, that we believe an examination of the divergent determinations reached by the Board are well warranted. In the two cases, it appeared that there had been,—A final determination of damages by the authority established to make that determination; an assertion by Great Britain of a liability for taxes. The order of the Commission not self-executing; an asser-

tion, or even assessment, of tax liability,—certainly not self-executing. A refusal of the railroads to pay the award; a denial by appellant of any tax liability, and a denial of the receipt of any income upon which any tax liability could be predicated. An action at law for collection; an offer to accept a reduced amount. A compromise and payment of less than one-half the amount of the original award; acceptance of the offer to accept a less amount, and payment of £120 instead of £280. Now, contrast the opinions by the Board:

“It was not known until 1920 what amount, if any, would be recovered, and, therefore, no basis for accrual existed prior to that time.”

“All of the events had occurred prior to the taxable year ended August 31, 1929, which fixed the amount of the tax due to the British Government and determined the liability of the taxpayer to pay it.” “The credits for the taxes in question were accruable in the prior years and may not be taken when actually paid in the taxable year ended August 31, 1929.”

And both results are reached by the Board under authority of *U. S. v. Anderson*, 296 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347.

Likewise, in the *American Code Company case* (*supra*), the Supreme Court refers directly to the few cases in which the Board departed from its usual rule and allowed deductions “in the year of the breach,” saying,

“In the few cases in which the (451) Board of Tax Appeals has allowed a deduction in the year of the breach, the contracts involving the purchase and sale of goods were performable in a comparatively short period; the approximate amount of the damages was reasonably predictable; negotiations for settlement had been commenced within the year and were completed soon after

its close; and the taxpayers had accrued on their books, at the end of the year, a liability reasonably estimated to equal the amount of the damages."

The opinion of the Supreme Court in the *American Code Company case* (*supra*) is reasonably to be taken as an approval by it of the action of the Board in the cases described. Now, the approximate amount of the taxes appellant might have to pay to Great Britain was not reasonably predictable, for so far as appellant was concerned that amount would be zero; there were negotiations, but throughout appellant contended, not that there should be an adjustment of the amount proposed, but that there was absolutely no liability; the agreement was not reached soon after the end of the taxable period; and the appellant had not accrued on its books, at the end of the year, any amount as a reasonably estimated amount of the liability for foreign income taxes.

United States v. Anderson (*supra*) does not conflict with this principle. The Supreme Court in deciding the AMERICAN CODE COMPANY case (*supra*), definitely states that the principle in that case, which was that first established by the Board, "is unlike *United States v. Anderson*," for "there, the liability for the munitions tax at a fixed rate on the business done for 1916 had confessedly accrued in that year and was a charge on the business of that year although the exact amount due may not have been then ascertainable and the tax was not payable until 1917." In *U. S. v. Anderson* there was no assertion by the taxpayer that liability for the munitions tax at a fixed rate on the business done in 1916 had not accrued in that year. As the court said, all the events had occurred fixing the liability of the taxpayer to pay a munitions tax,

there was no dispute on that score, the only thing to be ascertained was the amount. In our case, any and all liability to Great Britain was disputed, if it had had income in Great Britain a tax would have been due upon that income, but it denied strenuously that it had realized a profit on any sales it may have made there. Finally, as in the *American Code Company case*, appellant did not accrue on its books, in the prior years, a liability or reserve for an estimated amount of foreign taxes. It was of opinion that it had had no income, that, therefore, there could be no tax liability, and on that basis there could have been no warrant in fact, in accounting practice, or in law for accruing a tax and claiming the amount so accrued as a credit.

Section 131 (c) of the Revenue Act of 1928 does not in any way conflict with this principle, for again the provision is respecting the crediting of foreign taxes "paid" or "accrued," and again the construction to be given the words "paid or accrued" is definitely prescribed, as we have before stated.

The language of the section is:

"If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, * * *"

there shall be a proper adjustment. In fact, appellant had made no accrual, and we contend that there could be no accrual by it and that there was no accrual of liability for foreign taxes until it admitted that liability in 1929.

**Income Taxes Paid to Great Britain by Appellant
during the Fiscal Year Ended August 31, 1929,
Accrued during said Fiscal Year.**

As we have said before, appellant had, in its negotiations with the Department of Inland Revenue, denied

positively and strenuously that it was subject to a tax upon profits from sales made in Great Britain, and it went further and said that, even if it be held that it was trading in Great Britain, it had earned no profit upon any sales made there (Rec. 12). Not until within its fiscal year 1929, in October, 1928, did it admit any liability, and that admission was in consideration of an offer to reduce the tax proposed from £280 to £120. Not until it admitted the liability could it have accrued the liability for these foreign taxes, until that time the liability was contested and its amount was not susceptible of determination. Then it was that the liability accrued, and the fact of assessment by the Department of Inland Revenue was in no sense a determining factor. (*U. S. v. Anderson (supra)*).

In two cases that have come before it, the Board of Tax Appeals has considered questions of credits for foreign taxes, but the facts presented to the Board clearly distinguish those cases from the appellant's case.

The case of *MEAD CYCLE CO. v. COMMISSIONER*, 10 B. T. A. 887, did not involve the issue here before the court, for in that case the fact was that that taxpayer had accrued on its books of account taxes due to Great Britain on its branch in Birmingham, and the Board held, very properly, that the Commissioner should not have refused to allow the credit.

And in *W. J. BURNS, ET AL. v. COMMISSIONER*, 12 B. T. A. 1205 the question of law at issue before the Board was whether the foreign taxes that had been accrued on the books of account of a partnership were obligations of the partnership as such or obligations of the individual members of the partnership. But there had been an accrual on the books, there was no disputing of the liability for taxes, and by the time the

case came before the Board the taxes had been paid, so the Board quite properly directed that the amount paid be the amount of the credit rather than the larger amount accrued.

CONCLUSION.

We have shown the construction given by the Commissioner of Internal Revenue to the term "paid or accrued," that the Board of Tax Appeals has declared that the Commissioner's construction is the proper one, that the appellate courts have affirmed the Board's decisions, and reversed them when they varied from that construction, and that that construction has the approval of the Supreme Court. There being no prescribed difference in principle between deductibility from gross income and allowability of foreign taxes as a credit, the vital term being the same in each instance, "paid or accrued," we respectfully submit that the Board of Tax Appeals erred in its conclusion that the credits for the taxes in question were accruable in the prior years and not in the taxable year ended August 31, 1929.

It is, therefore, prayed that the Court reverse the decision of the Board of Tax Appeals and direct the Board to find that credit for taxes paid by appellant to Great Britain and in the amount of \$582.60 was properly and legally accruable and allowable as a credit in appellant's taxable year ended August 31, 1929, and to enter an order so holding.

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COURT OF APPEALS
DISTRICT OF COLUMBIA
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No. 594

Henry H. Stodges

CLERK

**In the Court of Appeals of the District of
Columbia**

APRIL TERM, 1933

RUSSELL-MILLER MILLING COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

SEWALL KEY,
J. LOUIS MONARCH,
S. DEE HANSON,

*Special Assistants to
the Attorney General.*

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In the Court of Appeals of the District of Columbia

APRIL TERM, 1933

No. 5941

RUSSELL-MILLER MILLING COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
Revenue, respondent

*ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS*

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in this case is that of the United States Board of Tax Appeals (R. 13-18), which is reported in 27 B.T.A. 405.

JURISDICTION

This petition for review involves corporate income taxes for the fiscal year ended August 31, 1929, and is taken from a decision (order of redetermination) of the Board of Tax Appeals entered December 22, 1932 (R. 18). The case is brought to this Court by petition for review filed March 14, 1933 (R. 19-23), pursuant to the provision of Sections 1001-1003 of

the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

QUESTION PRESENTED

Is petitioner, keeping its books and making its returns on the accrual basis, entitled to a credit against its income tax for the taxable year ended August 31, 1929, for foreign income taxes paid in that year on income for prior years?

STATUTES AND REGULATIONS INVOLVED

These will be found in the Appendix, *infra*, pp. 20-27.

STATEMENT

The facts as stipulated (R. 11-13) and as found by the Board of Tax Appeals (R. 14-15) are as follows:

The Russell-Miller Milling Company, a corporation organized under the laws of the State of North Dakota, with its principal office in Minneapolis, Minnesota, is engaged in the milling of wheat flour, and was so engaged in the years 1925, 1926, and 1927.

Petitioner's books of account were kept on the accrual method of accounting during the years herein mentioned, and on the basis of a fiscal year ending August 31, for each year, and its federal income tax returns were likewise prepared and filed on the accrual basis, for fiscal years ending August 31 in each case, and were approved by the Commissioner of Internal Revenue in these particulars.

During its fiscal year ending August 31, 1927, petitioner was called upon by the Department of Inland Revenue for Great Britain, to make its return

of Income taxes payable to Great Britain for the years 1925-1926, and 1926-1927. The Department of Inland Revenue aforesaid demanded audited accounts showing the profit or loss upon such sales; and, upon being advised that petitioner was unable to supply such accounts, sent assessments as follows (R. 14):

1925/26.....	£40
1926/27.....	200
1927/28.....	40
Total.....	£280

Petitioner denied any liability for such taxes, on the grounds, first, that petitioner was not trading in Great Britain, and was not subject to tax upon profits from sales made in that country and, second, that even though it was held that petitioner was trading in Great Britain, no profit has been earned upon sales made there.

In October, 1928, petitioner was advised by its London Agent that if said petitioner would admit its liability the Department of Inland Revenue might be willing to modify the above assessments to the following amounts (R. 15):

1925/26.....	£20
1926/27.....	100
1927/28.....	None.
Total.....	£120

On October 30, 1928, petitioner authorized its London Agent to settle on this basis, and on November 20, 1928, cabled £120, in payment of the amount agreed upon, the rate of exchange paid for this

amount being \$4.855, making a total payment of \$582.60.

During its fiscal years ending August 31, 1926, 1927, and 1928, petitioner did not accrue or enter upon its books of account any amount for such income taxes payable to Great Britain, and made no claim in its Federal income-tax returns for said fiscal years, for a deduction for such taxes, or for credit for taxes paid or accrued to a foreign country.

To its income-tax return for its fiscal year ended August 31, 1929, petitioner attached Form 1118, claiming credit of \$582.60 for taxes paid to a foreign country, which claim for credit has now been denied and disallowed by the Commissioner of Internal Revenue.

On the basis of the foregoing facts, the Board of Tax Appeals, affirming the Commissioner's determination (R. 4-9), held that the British taxes in question were accruable in years prior to the taxable year here involved, and that therefore petitioner may not be allowed credit for such taxes against its income taxes due for the taxable year ended August 31, 1929 (R. 18). The Board thereupon entered an order redetermining petitioner's tax liability to be \$5,110.65 (R. 18). From the order so entered, petitioner took this appeal (R. 19-23).

SUMMARY OF ARGUMENT

Where a taxpayer is on the accrual basis, it is settled that expenses may be deducted only in the year when the expenses accrued. A similar rule

applies to credits. It is also settled that liability for a tax is made certain by the statute imposing the tax, and the fixation of the liability is the event which determines the time of accrual. In this case petitioner denied liability for the British tax and contends that its denial of liability prevented the accrual in the earlier years and gives it the right to claim the credit in a later year. We submit that the accrual of the tax did not depend upon petitioner's admission of liability. The liability was fixed by the statute and petitioner's denial of liability did not make it contingent.

But if we are in error and the taxpayer's denial of liability should be held a sufficient reason for deferring the accrual of the tax, we submit that there should be a full showing of the facts and circumstances upon which the disclaimer of liability is based. Certainly a baseless claim by a taxpayer would not defer accrual. Even assuming that denial and contest of liability would defer accrual, then in order to justify postponing the accrual, it would at least have to be clearly shown there was a reasonable ground to deny the liability and that the question was sufficiently doubtful to render the liability contingent. There is no such showing here, and even if the principle for which petitioner contends should be conceded, the decision of the Board nevertheless should be affirmed for failure of proof.

ARGUMENT

Petitioner, keeping its books and making its tax returns on the accrual basis, is not entitled to a credit against its income taxes for the taxable year for British income taxes paid in that year on income for prior years

During the fiscal year ended August 31, 1927, the Government of Great Britain assessed against petitioner income taxes for years prior thereto (R. 11-12, 14). During the taxable fiscal year ended August 31, 1929, petitioner paid to the British Government a lesser amount of tax, as agreed upon, than the amount previously assessed. Petitioner, keeping its books and making its tax returns on the accrual basis (R. 11, 14), did not accrue or enter on its books, during the prior years, its liability, which it denied (R. 12, 14), for such foreign taxes, but claimed a credit therefor on its tax return for the taxable year during which they were paid (R. 12-13, 15). The Commissioner disallowed the credit thus taken for the reason that credits for foreign taxes must be taken by taxpayers on the accrual basis, not when paid, but when accrued (R. 5, 13-14). The Board of Tax Appeals held that the foreign taxes in question were accruable in years prior to petitioner's taxable year, and that therefore credit may not be taken for the latter year in which they were actually paid, since all of the events which fixed the amount of the taxes due to the British Government and which determined petitioner's liability to pay them had occurred prior to the taxable year (R. 18).

The only question to be determined is whether or not the petitioner, on the accrual basis, may at its option take credit for foreign taxes paid in the taxable year but accrued, we contend, during prior years.

Section 32 of the Revenue Act of 1928 (*infra*, p. 22) provides that taxes imposed by foreign countries shall be allowed as a credit against a domestic taxpayer's income taxes as provided in Section 131 of that Act, *infra*. Section 131 (a) (1) of that Act (*infra*, p. 22) provides that a taxpayer's income taxes shall be credited with taxes paid or accrued during a taxable year to any foreign country. Subdivision (d) of that Section (*infra*, p. 23) provides that credits for foreign taxes may, at the taxpayer's option and regardless of the basis upon which its books are kept, be taken in the year in which they *accrued*, and that they must be taken on the same basis thereafter. Section 43 of that Act (*infra*, p. 22) provides that such credits shall be taken for the taxable year in which paid or accrued, or paid or incurred, according to the method of accounting used in computing the taxpayer's net income. Section 48 (c) of that Act (*infra*, p. 22) provides that the terms "paid or accrued" or "paid or incurred" *shall be construed according to the method of accounting used in computing the taxpayer's net income*.

Article 697 of Regulations 74 (*infra*, p. 27) provides that the credit for foreign taxes may be taken in the return for the year in which they accrued or in which they were paid, dependent upon whether the

taxpayer's books are kept on the accrual or the cash basis; also that Section 131 (d) of the 1928 Act (*infra*, p. 23) permits a taxpayer, regardless of how its books are kept, optionally to take credit for such taxes as may be allowable in the return for the year in which the taxes *accrued*. This is a reasonable regulation, not inconsistent with the provisions of the statute, and should be given effect. *Universal Battery Co. v. United States*, 281 U.S. 580.

It will be noted, therefore, that, under the statute and the regulations, a taxpayer on the cash basis may take credit for foreign taxes either in the year in which accrued or paid, but, if on the accrual basis, then the credit may be taken only "in the return for the year in which the taxes accrued." Art. 697, Reg. 74, *infra*. Under no circumstances do the statutes or regulations permit a taxpayer to take credit in a later year than that in which the tax accrues. Clearly the option provided in Section 131 (d), *infra*, p. 23, is an election, regardless of the basis of accounting, to take credit for foreign taxes in the taxable year *accrued* or *accruable*, and not in the year in which paid. It is not an option to defer the accrual of such taxes until paid in a later and, perhaps, more advantageous taxable year. This is made manifest by Section 43 of the 1928 Act, *infra*, which requires credits to be taken in the year in which paid, accrued or incurred, *according to the method of accounting used in computing the taxpayer's net income*. Here, admittedly, the method of accounting on which petitioner's income was com-

puted was the accrual method (R. 11, 14). It therefore follows that any deductions or credits taken must necessarily be handled on the same basis; otherwise net income would not be clearly reflected as required by the Act.

The regulations require that each year's return, as to both income and deductions, shall be complete within itself and that expenses and liabilities in one year may not be used to reduce income of a subsequent year. They also provide that if the taxpayer does not within any year exercise its right of deducting expenses, *taxes* and other charges, it may not deduct them in a later year. Article 342, Regulations 74, *infra*. They provide further that statutory deductions are generally expenditures "connected with the production of income." Article 41, Regulations 74, *infra*. These provisions preclude petitioner, on the accrual basis, from postponing the crediting of the foreign taxes to the taxable year in which paid, but in which they did not accrue and to which they did not relate.

Article 341 of Regulations 74 (*infra*, p. 25) provides that if a taxpayer desires to take a credit for a period other than that in which it was "paid or accrued" or "paid or incurred", the Commissioner's permission so to do must first be obtained, but that in any event the taxpayer must first take the credit only on the return for the taxable period in which "paid or accrued" or "paid or incurred", as the case may be, according to the method of accounting used. But petitioner did not request or secure the Commissioner's

permission to do this, nor did it take the credit when it accrued, as required. Moreover, upon the assessment of the British taxes for the years 1926 and 1927, within the fiscal year ended August 21, 1927 (R. 14), or upon the payment thereof within the taxable year here involved, petitioner did not request a readjustment therefor in connection with its domestic income taxes as of the years ended August 31, 1926 and 1927, to which the foreign taxes applied, as it could have done under the provisions of Section 131 (c), *infra*. Under that subdivision petitioner, during the taxable year, could have notified the Commissioner of the payment of the foreign taxes relating to the taxable years 1926 and 1927, and, accordingly, credits and refunds would have been effected for such prior years' taxes as provided by the statute.

Failing this, petitioner may not now, by reason of payment of the foreign taxes during the taxable year, decrease its tax liability for that year by a credit for tax liabilities accrued in prior years. This would be tantamount to neutralizing the regulatory requirement that liabilities of one year may not be so used as to reduce the income of another year. Art. 342, Regulations 74, *infra*. It would also be permitting the taxpayer improperly to offset a credit against taxes for a year in which it did not accrue and to which it does not relate. Just as taxes and other charges, if not deducted in the year for which the right to deduct applies, may not be used to reduce income of a subsequent year (Article 342, Regulations 74, *infra*, p. 25), so credits for foreign taxes,

accruable in and relating to prior years, may not be credited against domestic taxes of a subsequent year. This is in harmony with petitioner's contention (Br. 6) that whether or not foreign taxes shall be allowed as credits is to be determined by the application of the same accounting tests as is used in determining the deductibility of items of deduction, a contention with which we do not quarrel.

Moreover, just as a statutory deduction may be taken only in a taxable year in which it was "connected with the production of income" (Art. 41 (c), Regulations 74, *infra*), so, also, foreign taxes (which petitioner admits (Br. 6) are governed by the same principles as are deductions) may be credited against domestic income taxes only in the year in which they were "connected with the production of income" and to which they relate; that is, in the year during which liability therefor accrued or was incurred. The conclusion seems irrefragable that since liability for petitioner's 1926 and 1927 foreign taxes *accrued* or was *incurred* in prior years, no one could seriously contend that they may be deducted or credited in the taxable year merely because they were due and payable, or paid in that year.

The theory of accruals was thoroughly considered in *United States v. Anderson*, 269 U.S. 422, which held that munitions taxes, assessable and payable under Title III of the Revenue Act of 1916 on account of net profits realized from the sale of war munitions during the year 1916, accrued in that year, and since that taxpayer's books and returns were on the accrual

basis, the munitions taxes were deductible from gross income for 1916, *when accrued*, and not in 1917 when due and payable. This sets at rest petitioner's contention (Br. 5-6) that the foreign taxes here accrued when "due and payable;" that they are allowable as credits for the taxable year because they accrued in fact and in law in that year, and that the Board therefore erred in holding that they may not be taken as credits in 1929 because they were accruable in prior years.

In order that income may be correctly reflected, it is necessary where income is computed on the accrual basis that all items, both of receipts and of disbursements, must be consistently included when accrued whether or not paid or received. *United States v. Anderson, supra*; *Aluminum Castings Co. v. Routzahn*, 282 U.S. 92; *United States v. Mitchell*, 271 U.S. 9; *Niles Bement Pond Co. v. United States*, 281 U.S. 357; *Continental Tie & Lumber Co. v. United States*, 286 U.S. 290. This doctrine of accruals is applicable also in determining the year in which the statutory credits for foreign taxes may be taken. *Mead Cycle Co. v. Commissioner*, 10 B.T.A. 887; *W. J. Burns v. Commissioner*, 12 B.T.A. 1209; *Columbus Carbon Co. v. Commissioner*, 25 B.T.A. 456. See also *D. E. Brown v. Commissioner*, 1 B.T.A. 446; *Albert D. Hewinson v. Commissioner*, 1 B.T.A. 1080; *William T. Rich v. Commissioner*, 11 B.T.A. 1320.

Accordingly, it is submitted that since petitioner's books were kept and its tax returns were made on the accrual basis of accounting, the foreign taxes for 1926

and 1927 must be treated on that basis, and may not, therefore, be credited against taxes computed on the income for 1929 when paid. It is beyond dispute that the British taxes for the years 1926 and 1927 accrued in those years, just as *United States v. Anderson, supra*, held that the munitions taxes for the year 1916 accrued in 1916, and not in 1917 when paid. Therefore, we do not quarrel with petitioner's contention (Br. 5) that since its books and returns were on the accrual basis, credit should be allowed for the British taxes in the year in which they accrued.

Petitioner's contention (Br. 7) that items of expense or other charges, or foreign taxes (Br. 19), do not accrue so long as any and all legal liability therefor is denied and contested by the taxpayer, is neither persuasive nor sound. It is obvious that the taxes accrued by operation of British law. Accrual of liability therefore could in no sense be considered contingent upon the taxpayer's disclaimer or contest. Moreover, the policy of the Treasury Department in this connection has been that a taxpayer may not be deprived of the right as of the taxable year involved to obtain credit for foreign taxes, even though it contests the validity of the statutes under which the taxes were paid, or because it protests the assessment and has made an application for a refund. S. M. 2243, IV-1 Cumulative Bulletin 231.

Conversely, it follows that a taxpayer may not, upon contest or disclaimer of liability, effect a postponement of the credit for foreign taxes so that the credit may be taken in a later year in which the taxes

did not accrue and to which they do not relate. While it may be contended that the amount of the contested foreign taxes is not definitely ascertainable as of a particular period, it is nevertheless evident that the taxes constitute a liability accrued, as of the year for which assessed, against the taxpayer by operation of law. If a taxpayer's protest against assessment prevails, any difference may readily be adjusted as provided by the statute and regulations. Section 131 (c), Revenue Act of 1928 (*infra*, p. 22); Article 697, Regulations 74 (*infra*, p. 27). In any event, the taxpayer must first take credit in the return for the taxable year in which the foreign taxes accrued, and it may be taken as of a different period only upon request of, and permission by, the Commissioner so to do. Section 131 (c), 1928 Act (*infra*, p. 22); Article 341, Regulations 74, *infra*. When the amounts of British taxes are finally ascertained, such correct amounts should be substituted for the amounts previously accrued and set up on the taxpayer's books. *W. J. Burns et al. v. Commissioner* 12 B.T.A. 1209, 1226.

Petitioner denied liability for the foreign taxes as of the prior years on the grounds that it was not trading in Great Britain and therefore was not subject to tax on profits from sales made in that country, and that even if it were held that petitioner had then been trading in that country, no profits were realized on its sales (R. 12, 14). The stated grounds of denial imply that petitioner actually did make sales in England during the prior years. Moreover, there is no showing whatever that petitioner

was not trading in Great Britain during the prior years, nor that it earned no profits from sales made during such time. The fact that the British Government assessed taxes on profits on sales made during those years strongly indicates that there must have been business transacted giving rise to taxable profits. Otherwise, there would have been no occasion for the assessment. The record shows that petitioner had an agent in London, and that, for unstated reasons, it did to some extent admit liability for the foreign taxes by payment in 1929 in a reduced amount (R. 12, 14-15). Furthermore, the record shows that petitioner was unable to supply the British Government with audited accounts showing profit or loss on such sales (R. 11-12, 14). Petitioner, therefore, authorized its London agent to settle with the British Government on the basis of a compromise as agreed upon (R. 12, 15). Whatever other grounds petitioner may have advanced to the British Government in prior years in substantiation of its disclaimer of liability are not shown.

If there were any reasons, valid or otherwise, for which petitioner should have been exempted from the imposition of the British taxes, it certainly has furnished no proof thereof. Neither has it shown any reasons why it admitted, in part, liability for the foreign taxes, and settled on a compromised basis. Clearly, as the Board held (R. 17), petitioner's liability for the taxes could not under any interpretation have been considered contingent upon petitioner's own recognition of the claim of the British Government, nor was the liability any less fixed or

certain because of petitioner's failure to admit it. For aught the petitioner has proved, and insofar as the record shows, all the events had occurred in prior years whereby petitioner's liability for the foreign taxes had become fixed, its denial of liability to the contrary notwithstanding.

Moreover, it would be a new thing in tax law if, to the detriment of the fisc, a taxpayer could at his own convenience circumvent or postpone accrual of liability for taxes merely by denial thereof, by contest, or by setting up a claim for exemption, later unsubstantiated. Fixation of liability, as here in 1926 and 1927, determines the time of accrual. This is settled by *United States v. Anderson*, *supra*, wherein it is stated (pp. 440-441):

Only a word need be said with reference to the contention that the tax upon munitions manufactured and sold in 1916 did not accrue until 1917. In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued.

Petitioner relies on *Lucas v. American Code Co.*, 280 U.S. 445, in support of the contention (Br. 7) that deductions from gross income, and likewise foreign taxes (Br. 19-26), do not accrue so long as legal liability therefor is denied and contested. In that case a loss by reason of a breach of contract by a corporate taxpayer, using the accrual basis in its books and tax returns, as determined by a final judgment several years after the year in which the breach occurred, was held not to be deductible as of the prior year in which the breach occurred. The reasons given were that the amount of damages, liability for which was denied and strenuously contested by the taxpayer, was *contingent* and wholly unpredictable and was not accrued, in the estimated amount of the loss, on the taxpayer's books within the taxable year.

The loss did not accrue, of course, until it was fixed by the termination of the contest leading to final judgment. In this connection the regulations provide that judgments for damages are deductible from gross income when the claim is finally adjudicated unless taken under other methods of accounting clearly reflecting income. Article 342, Regulations 74, *infra*, p. 25. Moreover, that case involved a *contingent*, contractual obligation, liability for the damages under which was denied by the taxpayer, and was not ascertainable or predictable at the time of the breach of the contract, the facts determining the liability depending on the course of future events. The liability did not become fixed until the matter had been finally adjudicated in a later year. That is

quite a different situation and readily distinguishable from the facts here involving an existing present liability giving rise to the accrual of the taxes, as in *United States v. Anderson, supra*, where all the events had occurred in a prior year fixing the tax and determining the liability of the taxpayer to pay it, and where, as admitted by petitioner (Br. 6), the taxes in question do not stand on any different footing from other accrued expenses of the taxpayer.

Moreover, the other cases cited by petitioner are clearly distinguishable from the tax situation here involved, in that they involve situations concerning liability arising from contested and disputed suits, claims, contracts, judgments or damages analogous to that in *Lucas v. American Code Co., supra*, and the determination and fixation of liability depended largely on the course of future events.

The gains or losses or amounts disputed in those cases were contingent and may never have been realized. Moreover, each of those cases turns on its own facts and circumstances, and is neither analogous to the instant case nor remotely persuasive toward a contrary conclusion from that contended for herein by respondent. Thus, for example, in *Thorne, Neale & Co., Inc., v. Commissioner*, 13 B.T.A. 490, relied on by petitioner (Br. 9-12, 20-21), the Board stated (p. 494):

We think it is clear that there is no election in a taxpayer to shift at his convenience the year in which the deduction for expenses must be taken merely by disputing the liability

where there is no reasonable ground to deny liability. It does not follow, however, that where a taxpayer in good faith and on reasonable grounds disputes the liability he must nevertheless charge himself with the liability on his books and render tax returns accordingly.

Obviously petitioner has not shown reasonable or any valid grounds for having disputed or contested liability for the British taxes in controversy, and therefore, in the absence of such showing, it may not shift at convenience the years in which the liability accrued and in which credit therefor should have been taken.

In view of the foregoing, it is submitted that the petitioner, keeping its books and making its tax returns on the accrual basis of accounting, is not entitled to a credit against its domestic income taxes for the taxable year ended August 31, 1929, on account of British income taxes paid but not accrued in that year on income for prior years.

CONCLUSION

It is respectfully submitted that the decision of the Board of Tax Appeals is correct, is in accordance with law, and should therefore be affirmed.

SEWALL KEY,
J. LOUIS MONARCH,
S. DEE HANSON,

Special Assistants to the Attorney General.

DECEMBER, 1933.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 200. When used in this title—

* * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. (U.S.C.App., Title 26, Sec. 931.)

SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer;
* * *. (U.S.C.App., Title 26, Sec. 953.)

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. * * *.
(U.S.C.App., Title 26, Sec. 984.)

SEC. 238. (a) In the case of a domestic corporation the tax imposed by this title shall be credited with the amount of any income, war-profits, and excess-profits taxes paid or accrued during the same taxable year to any foreign country, or to any possession of the United States: *Provided*, That the amount of such credit shall in no case exceed the same proportion of the tax (computed on the basis of the taxpayer's net income without the deduction of any income, war-profits, or excess-profits taxes imposed by any foreign country or possession of the United States), against which such credit is taken, which the taxpayer's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bear to its entire net income (computed without such deduction) for the same taxable year. In the case of domestic insurance companies subject to the tax imposed by section 243 or 246, the term "net income" as used in this subdivision means net income as defined in sections 245 and 246, respectively.

* * * * *

(c) The credits provided for in subdivision (a) of this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping its books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subdivision (b) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis. (U.S.C.App., Title 26, Sec. 990.)

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 32. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.—The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax, to the extent provided in section 131.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.—The deductions and credits provided for in this title shall be taken for the taxable year in which “paid or accrued” or “paid or incurred”, dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 48. DEFINITIONS.—When used in this title—

* * * * *

(c) *Paid, incurred, accrued.*—The terms “paid or incurred” and “paid or accrued” shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.—(a) *Allowance of credit.*—The tax imposed by this title shall be credited with:

(1) *Citizen and Domestic Corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; * * *

* * * * *

(c) *Adjustments on payment of accrued taxes.*—If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole

or in part, the taxpayer shall notify the Commissioner, who shall redetermine the amount of the tax for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 322. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as the Commissioner may require, conditioned upon the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(d) *Year in which credit taken.*—The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis.

Treasury Regulations 69, provide in connection with Section 200 (d) of the Revenue Act of 1926, *supra*, as follows:

ART. 1523. "*Taxable year,*" "*withholding agent,*" "*paid or incurred,*" and "*paid or accrued.*"— * * * . The terms "*paid or incurred*" and "*paid or accrued*" will be con-

strued according to the method of accounting upon the basis of which the net income is computed by the taxpayer. The deductions and credits provided for in Title II must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the statute, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

Treasury Regulations 74, promulgated pursuant to the Revenue Act of 1928, provide as follows:

In connection with Section 21—

ART. 41. *Meaning of net income.*—The tax imposed by the Act is upon income. In the computation of the tax various classes of income must be considered:

* * * * *

(c) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. (See sections 23 and 24 and the articles thereunder.)

In connection with Sections 43 and 131 (c), *supra*—

ART. 341. "*Paid or incurred*" and "*paid or accrued*."—The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The deductions and credits provided for in Title I must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Act, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

ART. 342. *When charges deductible*.—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. (But see section 117 and articles 651-655.) A taxpayer has the

right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year including such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. (See section 322 and articles 1251-1257.) A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained.

In connection with Section 131 (a) (1) (c) and (d),
supra:

ART. 697. *When credit for taxes may be taken.*—The credit for taxes provided by section 131 (a) may ordinarily be taken either in the return for the year in which the taxes accrued or in which the taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Section 131 (d) allows the taxpayer, at his option and irrespective of the method of accounting employed in keeping his books, to take such credit for taxes as may be allowable in the return for the year in which the taxes accrued. An election thus made under this section or under section 222 (c) or 238 (c) of the Revenue Act of 1924 or 1926 must be followed in returns for all subsequent years.